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# Nicaragua: Business Opportunity Strategy

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## Executive Summary

Nicaragua has been blessed with great wealth. Its land mass, strategic location, natural resources, and low population density endow this country with innate opportunities. However, a series of external and internal factors, have produced an outcome of widespread poverty caused by missed opportunities, social and geographic fragmentation, and a significant misuse of its natural resource base. Although many of the root causes may have disappeared, the inertia of the past and an obsolete institutional framework continue to impede the transformation of wealth into a base for inclusive prosperity. In Nicaragua, markets can be exploited, capital accumulated and prosperity achieved only if resources can shift freely from low to higher value markets and the innovators can find capital. Other enabling requisites necessarily include: the opportunity for the factors of production to change hands while avoiding plutocratic concentration; land titles can be trusted and transferred; property rights are respected; and public goods can be funded.

## I. Background

Almost 50 percent of Nicaraguans today are poor and one out of five lives in extreme poverty. The gross domestic product for 2003 grew by 2.3 percent, which implies that per capita income has fallen for the third consecutive year. To reach the Millennium Development Goals (MDG) by 2015, meant to cut poverty in half, growth must accelerate to over five percent. Nevertheless, accelerated or even stable high growth rates have not necessarily led to sustained development in Latin America. The major problem faced by Nicaragua, as in most Latin American countries and some Caribbean islands, is unequal income distribution.

*Unequal land distribution*. In 1995 the Gini coefficient for farm areas was a high 0.75. By 2001 this number had improved to 0.71 with 70 percent of the 295,000 farms occupying 10 percent of the area. Benefits accrue to the six percent of landowners that control 55 percent of the eight million manzanas in farm land, a problem further aggravated by the lack of clear titles, which affects investment decisions of those owning the larger farms. The small size of most farms (50 percent own less than five manzanas) limits the capacity to shift to new crops, or invest in soil and water conservation, tree crops or forestry.

*Unequal access to education*. During the nineties, the wage differential widened between those with a high school education and those without. The relative incomes and employment of professional and technical wage earners to unskilled workers jumped from 2.31 in 1993 to 2.79 in 1998. Spot surveys indicate that this situation has deteriorated further with significant regional differences.

Nicaragua, like the rest of Latin America, focused on expanding primary and university education. Secondary education, however, has not kept pace and has become a stalling point for the relatively few who graduate from grammar school.

Figures for average market wages in free zones (including social security and other fringe benefits) show that, compared to the region, Nicaraguan labor earns less than $0.70/hour. Figures for the region show Honduras at $1.08/hour; El Salvador $1.30; Guatemala $1.32; and Mexico $2.15.

*Rural versus urban labor.* Rural workers earn a quarter less than urban workers, and formal workers earn less than informal workers. Poverty and extreme poverty, therefore, tend to prevail in rural areas.

*Biased judicial systems* enforce the law in random fashion, usually benefiting those who can afford to influence outcomes. During the sixties, it was maintained that the criminal code was written and enforced to protect a small wealthy minority from an ocean of frustrated poor people, while the commercial code was designed to remove the protection of the poor from that minority. Property rights are worthless if courts do not honor them; investments cannot be made if regulations cannot be enforced; and employers cannot risk expanding their labor force when an elite minority control the markets.

*Biased and poorly functioning capital market.* Nicaragua's capital market generates high returns only for a few, denying opportunities for the rest, with small and medium enterprises bearing the brunt. Nicaragua still shows the influence of past traditions where financial institutions may accumulate the savings of the population to finance operations of their own. No one is clear as to who lost real money in the banking crisis that weakened the emerging growth rate and drastically increased the internal public debt.

According to the Hecksher-Ohlin model, Nicaragua, with its wealth in land and unskilled labor, would attract investments in unskilled and land intensive products. Openness to trade and capital would lead to a narrowing of wage inequality between skilled and unskilled workers.

### Leadership Seeking Tranformation

Nicaraguan leaders at all levels are seeking immediate steps to lead this country into the new century. A sense of urgency permeates the discussions and actions followed by progressive groups seeking accelerated change. Strong signals demonstrate that rhetoric is becoming action. Few countries have had the courage to address corruption at the highest levels of government as Nicaragua has done. Structured public opinion fora, such as *mesas*, allow key actors in different sectors to openly present views. The consultative process to draft the national development plan demonstrates a commitment to participatory democracy and a will to tackle fundamental institutional changes.

The creation of the conditions for inclusive prosperity demands sustained efforts from progressive leaders and international allies. The alternative, to focus exclusively on high economic growth, such as the levels reached during the sixties and early seventies[1] would not drive the social and economic dynamics required to compete in the global arena. Capital flight will overcompensate large capital transfers received by this very small economy through remittances, foreign assistance, or foreign direct investment ($171 million in 2002). Absent inclusive instruments, economic growth could become a race to the past.

### Nicaragua's Positioning in the Global Culture: Choosing Between the Burden of Social Mortgage and the Winds of Prosperity

Currently Nicaragua's positioning builds on the burden of its social mortgage. The global positioning as the second poorest nation[2] in the hemisphere attracts capital flows arising from its economic malaise: remittances and foreign assistance. This global positioning has worked: in 2002, remittances surpassed $760 million/year (or 17.4 percent of GDP, second in the hemisphere only to Haiti's 24.5 percent) and compares well with those received by Honduras ($770 million) or Guatemala ($1.7 billion).

At a time when donors have shifted significant resources to sub-Saharan Africa and the Middle East, Nicaragua has managed to attract their sustained support. Just two donors, the United States and Japan, provided grants for $50 million annually during 1997-2001. The Inter-American Development Bank and the World Bank may lend close to $150 million annually over the next

[1] Nicaragua was the regional growth leader, after Costa Rica, in 1975
[2] $550/capita; PPP $2,366/per capita in 2000. Haiti leads the league of dysfunctional states, PPP $1,467/pc in 2000.

three years. Even the EU, focused on Eastern Europe, will also increase its aid to $50 million a year. People estimate that more than $10 billion dollar in donations and soft loans has been given to Nicaragua since 1990.

This will not continue. Donors' funding shifts to meet new challenges and remittances may be drastically reduced by changes in migration laws beyond the influence of Nicaragua's political reach.

### Has the Social Burden Position Worked?

Perhaps a more pertinent issue revolves around a different question. Are these flows working? Real per capita GDP and income levels are lower than those of the sixties and seventies. Economic growth trends indicate volatility, dropping from a robust 5.4 percent growth rate in 1996-2000 (7.4 percent in 1999) to 1 percent in 2002.

Nicaragua's competitiveness index has dropped from 73/01 to 75/02 and 90 last year (compared with Chile at 28 or El Salvador at 48 in 2003). Only Honduras at 94 surpassed Nicaragua in 2003.[3]

Total factor productivity has also been declining. The annual growth in total factor productivity (average for the nineties) has oscillated around a -1.5, not as poor as Venezuela (-1.8), Honduras (-1.9), Jamaica (-3.1) or Haiti (-4.2), but below every other country in the hemisphere.

The Index of Economic Freedom 2003 of the Heritage Foundation measures the business environment and is a composite of a number of indicators including property rights, regulation and government intervention: Nicaragua ranks 72, far behind its regional partners like El Salvador (26), Costa Rica (44) and Guatemala (56). The outlook is bleak for improving competitiveness and employment opportunities

The type of resources Nicaragua attracts makes limited contribution to economic growth, however they do improve social capital. Improvements in education are a case in point, but better educated people in a poor economic environment may become better educated migrants.

### Learning from Other Models

The country must change its positioning from No. 2 in poverty. This positioning helps meet social needs and attract donor support but no country has developed solely on foreign aid. The main engines of growth are domestic savings and investments, and increased physical, social and human capital. Observe models like the Dominican Republic prior to the start of its banking crisis; or El Salvador's maquila, which generates 60 percent of its exports; or Honduras' and Guatemala's winter vegetables, all alternative venues toward economic growth.

Those countries that lag behind in development can learn from the trials and errors leading to successes of others positioning themselves in the global market. The danger is that by the time

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[3] Like the Gini coefficient, the Productivity Index is inversely related to the variable measured, the higher the value, the lower the performance, US ranked second, for example, in 2003.

lessons are learned, a complete new set of rules control competitiveness, making time a crucial factor. Further, quickness in response to opportunities drives the probabilities of success or stagnation.

### Responding Quickly to Opportunity

Major barriers to timely response to opportunities are administrative hurdles resulting from obsolete rules and regulations, corruption, and isolation from change elements that spur other countries' economies to overtake and surpass those that fail to streamline and adjust.

The World Bank Group provides recommendations on barriers (see Annex A), which are fully endorsed here, with one caveat. Experts, aware of the damage that barriers cause, want to see action to dismantle them soon as possible.

This analysis' timeframe for action is truly ambitious. Proposed recommendations to eliminate barriers could be bolstered by the analysis of a political scientist to determine probability for success and an approach to building constituency to support recommendations.

The Nicaraguan government, its private sector and civil society usually do not act on reports and recommendations, not because corruption or inertia impedes it. Rather, this country has been flooded with valid recommendations focusing on limited managerial or institutional capacity. When supply increases and demand is inelastic at very low "quantities," no transactions take place with additional supply. Supply and demand must work in tandem in order to have a market. One fears that recommendation makers and recommendation users are sometimes operating in different quadrants — the "curves" miss each other completely; there is no Walrasian clearing.

During discussions held for this preliminary survey, the author was frequently told that neither the country, nor the private sector, needed any more reports, but a business plan to move forward. But after reading the copious and fine reports produced, perhaps the right question should be why are these reports, written by the best and the brightest in Nicaragua and the development industry not used? And, why should some ask for a study of all the studies?

A recommendation to support private sector development should be to include private sector organizations in the design of the scopes of work for future work, participating in the definition of who will be the client, who will be responsible for follow-up, and who will be accountable for the quality of the report and its recommendations. This is not offered lightly, but the private sector must be increasingly engaged with the development industry and its performance in Nicaragua. A key element in many reports is the lack of translation. Usually, the translation into Spanish is considered enough. That is, of course, necessary, but usually not sufficient. There must be a forum that translates the concepts into the images and symbols understood in the cultural setting of Nicaragua and understandable to the reference group targeted by the analysis, report or study. For example, isn't it disturbing that most universities do not have copies of reports made and that these reports are not discussed by its faculty or student body? In a country with a high rate of illiteracy and distorted views of private sector functions (basically built around an extreme type of private sector — predatory plutocratism), shouldn't universities be engaged in this process of knowledge sharing? Stand-alone analysis, without follow-up to assess and implement recommendations should be avoided. Unfortunately, the report is viewed as the end product. Shouldn't the report be viewed as the end of the beginning?

## II. The Quality of Growth Matters

To reach the Millennium Development Goals (MDG) by 2015, Nicaragua's growth must accelerate to over five percent. But high growth rates will not be sufficient; the country also has to seriously address the issue of income inequality. This implies addressing issues such as: (a) land distribution, (b) labor inequality—based on access to education and knowledge, (c) labor segmentation—rural workers earn less than urban, (d) biased judicial system—which favors those who can afford to influence the outcomes, and (e) inefficient capital market—which burdens the development of the SME sector, among others.

Likewise, Nicaragua needs to change its development strategy from a dependency on donor support to a dependency on domestic savings and investments. Nicaragua, as the second poorest nation in the hemisphere, attracts remittances and foreign assistance. But after more than $10 billion dollar in donor support since 1990, a pertinent question is: Are these flows working? Real per capita GDP and income levels in Nicaragua are lower than those of the 1960s and 1970s, inequality continues to be unsustainably high, economic performance remains weak, the country's competitiveness position continues to deteriorate as compared to its neighbors, total factor productivity remains negative, and the country's economic freedom index remains behind regional levels. Therefore, foreign aid in Nicaragua has failed to boost the country's competitive position, create jobs opportunities and improve the country's inequality; notwithstanding the increase in social capital—health and education—that have resulted from this support. No country has developed solely on the back of foreign aid and Nicaragua is not the exception. Private sector development and social inclusiveness should be strongly promoted. But time is of essence in a knowledge-based era so Nicaragua has to move quickly in establishing the appropriate conditions that would lead the country in the right direction to a prosperity path.

## III. Gates to Prosperity

Three elements, among many others, provide powerful pathways to the necessary institutional transformation in Nicaragua: CAFTA, HIPC, and the government's anti-corruption program. Corruption in Nicaragua increases uncertainty, shortens investment horizons, limits competition, aggravates transaction costs, and causes massive damage to the investment environment. Customer-based businesses, like tourism, can seldom thrive under a highly corrupt environment. Migrants fear joining development programs or investing in their own communities when the uncertainty caused by corruption becomes overwhelming. Unless there are significant rents, FDI tend to flow to environments with lower corruption, uncertainty and risk. This report addresses a series of suggestions for Nicaragua to take full advantage of CAFTA and to set the course towards a path of inclusive prosperity.

On the other hand, neither the CBI nor CAFTA have been designed to boost traditional economic activities or exports. They benefit what does not yet exist. CAFTA, like the CBI, is designed to attract investment and encourage trade in new economic ventures by providing a permanent set of trade benefits. CAFTA reduces uncertainty and encourages the shift in the use of abundant resources (land and labor) to new activities with markets in the U.S. CAFTA could lead its competing neighbors to displace Nicaragua in the attraction of capital or markets if the country doesn't move quickly to establish the appropriate conditions to encourage trade and investment in a socially inclusive environment.

Finally, reaching the Completion Point under the Enhanced HIPC Initiative has significantly improved the country's economic sustainability by significantly reducing the stock of foreign debt for the country. Nicaragua needs to quickly establish an appropriate policy framework conducive to trade, investment and business development as a necessary step to promote sustainable growth. There has to be a conscious effort to avoid re-entering into a new debt spiral that could again threaten future sustainability.

## IV. Suggestions to be Considered by the Government of Nicaragua

### A. Economic Governance

Nicaragua needs stronger private sector organization. The country needs to reinforce the emerging capacity of Pro-Nicaragua and avoid the duplication of functions through other organizations. Instead of initiating more studies, the effort should be placed in forging strategic alliances to further private sector development and competitiveness such as the one forged between FUSADES in El Salvador and FUNDESA in Guatemala. A collaborative project submitted by two organizations like this, could attract public and private support.

The integration of the Nicaraguan space to productive uses is crucial. The best field technology can be defeated in the market if transportation costs continue to increase ahead of competition. The establishment of a $0.10 levy per gallon of fuel for road maintenance should be managed by a public-private authority that would be in charge of bidding out the maintenance contracts at the local and regional level. Additionally, this broad based authority would be ultimately responsible for providing accountability, transparency, and granting awards.

### Governance and Government

Two principles guide success in achieving inclusive prosperity: Create the enabling environment to help the private sector benefit from CAFTA; and create the instruments to ensure the poor majority shares in the benefits.

When the government holds a monopoly over governance, bureaucracy reigns supreme, corruption thrives, and checks and balances disappear. The modern state, within the confines of orthodox government procedures and strictures, cannot change quickly in response to realities brought by a quickly globalizing economy. Peripheral organizations can provide the services of governance without forming a formal part of the government. Like Gothic cathedrals, these organizations form the counter-forts that sustain the weight of the building from the outside. Based on one week's analysis, the authors makes two suggestions; further study is necessary to make adequate recommendations.

In the area of trade and investment, the private and public sector need to reinforce the emerging capacity of Pro-Nicaragua and avoid duplication of functions by other organizations. Many of these organizations have fallen far short of expectations after absorbing significant resources often from donor countries. Strong business plans should be established and a review process enforced.

The formula is to form alliances with leading organizations that could become partners in development, especially at the regional level. Instead of looking for foreign technical assistance, the Pro-Nicaragua Board may consider forming an alliance similar to the one emerging between FUSADES in El Salvador and FUNDESA in Guatemala. FUSADES has developed unique expertise and is a regional pioneer in promotional activities. Its work with the private and social sectors has pioneered the concepts of corporate social responsibility in a skeptical environment. Its work with small and medium enterprises has focused on promoting domestic investments and local innovations. The author has discussed this possibility with senior managers in the organization and they are willing to consider this type of proposal. A joint project submitted by two organizations like this, could attract public and private support. Furthermore, this type of alliance could pave the way to attract more Salvadoran capital and skills to Nicaragua. Other options are available in the region. The key concept is to jump start the process by forming alliances with “benchmarkers,” preferably in the Central American region.

The integration of the Nicaraguan land area into productive use is crucial. The best technology in the fields can be defeated in the market if transportation costs continue to increase ahead of competition. A trust fund for road maintenance is urgently needed and required by all the segments of society. The negotiations with the IDB lead toward the establishment of a $0.10 per gallon fuel levy. This trust fund should be established independently of the former state apparatus so that it can be audited. A public-private authority should receive these funds, award the maintenance contracts, bid them out at the regional level and within the CAFTA and CACM principles, and provide accountability and transparency. The levy should be paid by everybody, including diplomats and those in the development industry. Counter-intuitively, this type of transfer of power can only be done with honest public administration where management delivers on requirements. But it only takes one incompetent and/or immoral manager to destroy it. By placing it under an independent authority, the probabilities of success are significantly increased.

These two examples illustrate key pieces of governance to strengthen the development role of the private sector and the nurturing role of the public sector. Many opportunities exist; the formula is well known. The sense of urgency and the need to produce results that lead toward solutions to the next wave of challenges makes this approach crucial to improve governance without increasing government.

### B. Development of the Maquila Sector

The maquila operation is an example of a success story. Domestic capital is beginning to move into it, and CAFTA has opened up new opportunities for expansion. A targeted campaign should be launched to attract countries that are losing benefits based on income levels and alliances should be fostered with large free trade zone operators in the region.

Nicaragua should also take advantage of the existing construction expertise in the region and apply this knowledge to expand its free trade zone facilities—facilitating work permits and forging alliances with regional construction consortiums.

One area that promises potential to expand job creation in Nicaragua and to improve overall competitiveness of the country's export sector is the expansion of the free trade zone benefits to the entire exports chain. This action would allow FTZs to provide high quality inputs at low competitive prices to the national export industry.

### In-Bond Production of Goods and Services — Maquilas

The maquila operation is a success story. Domestic capital is beginning to move into it. After CAFTA, Nicaragua and Honduras can continue with current FTZ status as long as their per capita income remains below the US$1,000 level. Nicaragua was also able to maintain the provision under which FTZ can internalize up to 40 percent of production after paying for local taxes. Therefore, the tax holidays afforded to this industry should be maintained for the time being. A targeted campaign should be launched to attract countries that are losing benefits based on income levels (e.g., per capita above $1,000) and alliances should be fostered with large free trade zone operators (e.g., Grupo M in the Dominican Republic).

The maquila sector is currently constrained by the lack of facilities. Guatemala has developed a solid construction industry that could assist in the quick construction of the factory space urgently needed. Others exist in the region. To facilitate the participation of regional contractors and capital in this activity should be a priority to the different actors promoting investments in the country. A critical issue is worker permits. A fast track or special treatment channel should help facilitate the participation of needed expertise available in other countries within the region for national, regional or international investors.

The Dominican Republic pioneered the use of maquila to decentralize population and urban hypertrophy. Changes in port facilities and road infrastructure could lead to sites where maquila operations could be directed away from Managua. These opportunities should be encouraged and not discouraged. In some countries, this "competition" has been stifled by interest groups in the capital city.

The textile sector will gain importance thanks to new CAFTA opportunities. Negotiations around the Multi-fiber Agreement and its expected abrogation early in 2005 may cause some fast and furious changes in the placing of orders to different countries. This should be carefully monitored—no need to suffer a "coffee crisis" in textiles if the information is carefully tracked and assessed.

One area that promises potential to expand job creation in Nicaragua and improve overall competitiveness of the country's export sector is to expand free trade zone benefits to the whole exports chain. Through this action Nicaragua would take advantage of higher technologies input products being utilized throughout the export products chain (i.e. boxes, plastic containers, packaging, labeling, etc.).  This single effort could imply a significant boost to the domestic export industry, though it could generate some opposition from internal interest groups exercising monopoly rents. In any event, this should be one of the points discuss while drafting a new Incentive Law for maquila operation in Nicaragua in the next couple of months.

*Caveat*. Free trade zones, by themselves, will not accelerate development. El Salvador, for example, with 60 percent of exports from maquila, had an estimated GDP growth rate that might not reach two percent in 2003. Maquila is important to improve procedures and strengthen the public sector capacity (e.g., labor, economy and health ministers) to address modern manufacturing and trade issues. It focuses pressure on improving infrastructure bottlenecks. Perhaps the most important contribution is to train managers and foremen, and introduce workers to the exacting demands of manufacturing processes. It shows how the right policies and organization can accelerate the attractiveness of a site for investments and orders. Based on these factors, the in-bond operations can catalyze improvements in the national business environment outside the maquila. If those improvements do not take place, then the maquila will remain an enclave institution and not an agent of growth for the nation. They are beneficial in limited capacity, but by themselves, they seldom produce the required development dynamics.

## C. Transportation

Most Nicaraguan exports suffer higher costs because they are shipped out of Puerto Cortez in Honduras. The transit through the Honduran-Nicaraguan border adds incredible costs to Nicaraguan shipments. By focusing on this specific crossing and making it the focus of negotiations with Honduras, Nicaragua can significantly lower the transport costs of its exports.

Nicaragua may explore the negotiations being carried out by El Salvador and Guatemala with Honduras to establish peripheral custom houses at Puerto Cortez. This would facilitate transportation and reduce trading costs as well as make the national industry and agribusiness more competitive.

Transportation continues to plague the region in general and Nicaragua in particular. Most Nicaraguan exports suffer higher costs because they are shipped out of Puerto Cortez in Honduras. In this respect, two specific actions may warrant short term priority.

The transit through the Honduran-Nicaraguan border adds incredible costs to Nicaraguan shipments. By focusing on this specific crossing and making it the focus of negotiations with Honduras, this hurdle could be cleared. Technically it is very simple. The political will and shadow rewards are usually the stumbling blocks.

In addition, Nicaragua may explore the negotiations by El Salvador and Guatemala with Honduras to establish peripheral custom houses at Puerto Cortez. Once again, this would facilitate transportation and reduce trading costs making the national industry and agribusiness more competitive.

In transportation, a lot has been written on Puerto Corinto in the Pacific. El Salvador, however, will invest close to $20 million dollars of Japanese financing in a container port in the Fonseca Bay at Puerto Cuatulco, anchoring in the Pacific the dry canal running from Puerto Cortez to the Gulf to Fonseca. This will change the economic dynamics of the whole border region and the cabotage trade on the Pacific side of Central America. Under the Plan Puebla Panama (PPP) infrastructure component, the IDB is planning a major investment in roads. The road network potentially feeding into this new transportation hub and network should be factored in.

The important element for Nicaragua is not if a port is national or regional. The crucial point is if it will make its economy and society more powerful or not. Port authorities are usually poorly placed to deal with business in ports beyond their own jurisdiction. Under the governance recommendation above, the public-private authority dealing with ports and airports may be reinforced and make recommendations on how to optimize the benefits from this Pacific initiative.

At the regional level, Nicaragua's transportation users and providers could join forces with their homologues in the other CACM countries to establish a regional logistics authority or council. The costly monopoly in air transport could be addressed among other more mundane issues (like the gradual establishment of a common tariff, and related transactional barriers to a more competitive trade flow). Nicaragua would benefit significantly from improved trade, investment and labor flows in the region.

### D. Improving the Country's Image

A change in positioning requires a change in image. In the case of Nicaragua, the most important element to change is the image associated with the country's credit rating. By focusing on this specific indicator and making the adjustments required to improve it, significant benefits will accrue to the country. An improved country credit rating will result in access to guarantee funds that could be geared toward encouraging the small and medium enterprise and agribusiness sectors. Additionally, this would help create the necessary conditions for the return of international banks to Nicaragua which in turn would increase the confidence of foreign investors in the country. HIPC has fomented a positive and enabling environment for the country to pursue this important effort.

### HIPC

Nicaragua has recently reached Completion Point under the Enhanced Highly Indebted Countries (HIPC) Initiative. Through this Initiative the rich countries in the World erased some $4.3 billion dollar of Nicaragua's $6.2 billion dollar foreign debt. Reaching Completion Point not only provides evidence of Nicaragua's commitment to economic reform but also provides ample opportunities for the country to redirect resources from debt service payments to meet important development objectives and anti-poverty projects.

The HIPC Initiative also helps Nicaragua improving its international image. The lower stock of foreign debt not doubt improves the country ability to face its internal and external development challenges. International banks, credit rating houses, as well as private creditors will now have a better sense of Nicaraguan economic sustainability. Nevertheless, a conscious effort is needed to avoid re-entering a new debt spiral that could again threaten future sustainability. In this sense, the GON efforts to reduce fiscal deficit and fight corruption must continue while the country as a whole must shift to a new development paradigm where domestic savings and investments became the true engines of growth and under which important gaps in social capital formation and infrastructure can be addressed.

### National Image Management

A change in positioning requires a change in image. But promotional campaigns and related approaches usually cost a lot more than they produce. Image changes usually respond best to concrete and measurable events that mark it. In the case of Nicaragua, the most important element to change its image and move away from its poor No. 2 positioning is the country credit rating. By focusing on this specific indicator and make the adjustments required to improve it, significant benefits will accrue to the country. If there is one suggestion that merits close consideration, it is this one. Nicaragua will collapse with another financial crisis. Countries do not fail like companies; they just explode in violence. The benchmark here is Haiti, one to be avoided. Another point of reference is the enormous cost of the current banking crisis in the Dominican Republic. The Central Bank and related authorities and leaders in the financial community will do well in sending a mission to the Dominican Republic to discuss with Dominican leaders and analysts what lessons have been learned and how this horrific type of meltdown could be avoided. USAID in Nicaragua could help the government arrange for this hands-on workshop after the political situation calms.

A benefit from achieving an improved country credit rating is access to guarantee funds. Several donor organizations have flexible guarantee schemes and similar risk sharing instruments. Nicaragua needs credit facilities to encourage its small and medium entrepreneurs and agribusiness. By improving its credit rating, the healthier financial image will help these groups and the national banking community to access these facilities.

A fine facility for example, is USAID’s Development Credit Authority. One concern is the total absence of instruments or policies to assist the small and medium entrepreneur. Credit is usually a major constraint. Nicaragua’s banking association and central bank may improve the national economy and their own bottom line by using these facilities for the benefit of the SMEs.

Direct foreign investment is a continuing preoccupation in Latin America. Nicaragua is no exception. And yet, a key symbol that inspires confidence in a country is the active presence of foreign banks. They are the ones that provide the investment referrals demanded by their clients, and that offer the trust required to manage the investor’s funds and transactions. What could be done to attract more active international banking in Nicaragua? This is an activity where the Central Bank could receive specialized counseling.

## E. Tourism

Nicaragua can exploit limited tourism options. It does not have the facilities or the mind-set to exploit a sustained drive to become a significant tourism center. One option is for Nicaragua to start building its tourism flow by focusing on creating tourism opportunities for the Nicaraguan Diaspora living in the United States and Costa Rica.  In order to attract some of the visitors who travel to the region, Nicaragua needs to offer good value for the tourist’s money. From these humble beginnings a major industry can be built. Key areas such as environmental management should be addressed from the beginning. Nicaragua should carefully examine the type and level of subsidies provided to tourism developers. Targeted subsidies may have their benefits, but it is more important to direct public funds towards building and leveraging public goods that will not only benefit the tourism sector, but will also benefit the Nicaraguan populace in general. Extending public funds, such as improved roads, water and sewer connections, training facilities, better managed coastal areas, and establishing conditions that allow and encourage the private sector to provide better power and telecommunication services to potential tourism poles are clear examples of leveraging these benefits within a broader social context.

Nicaragua can exploit limited tourism options. It does not have the facilities or the mind-set to exploit a sustained drive to become a significant tourism center. Neither did the Dominican Republic when they began their drive in the early seventies. Everything was spoiled, plastic cups soiled their beaches, there were no roads. It was, frankly, a total disaster. The Dominican Republic began to build their tourism flow with visiting the Dominican Diaspora (winter in New York or in the beaches of your home land?) and with the Puerto Rican visitors. It offered good value for the tourist's money. And from these humble beginnings a major industry was built. Special funds were established in the Central Bank to share the risks of investments in tourism and to provide hands-on technical assistance. A significant study was done to map out tourism potential and it was analyzed and scrutinized by key Dominican and international investors. Today, the number of visitors runs into the millions and the number of rooms built in one year surpass the total number existing a few years ago.

Nicaragua could partner with Dominican institutes and private sector organizations to, in all honesty, learn from them and do it better. A key area missed by the Dominican developers, for example, was the environment …and tourists want a clean environment. It is significantly less expensive to deal with the interaction between tourism developments and the environment beforehand rather than after.

Given the tourism boom in Costa Rica, formulas for multi-destination tourism will probably begin to expand the number of visitors and the length of stay both in Costa Rica and Nicaragua. The author heard that a significant study was done in Nicaragua, which cost approximately a million dollars, but was unable to review it.

Tourism schemes to transfer public funds to crafty financiers are found all over the world. These groups make their profits from project financing and not from project management. Any type of subsidy to any sector, and tourism in particular, should be viewed with frank skepticism. Subsidies might have their role, but it is relatively small in the development equation of any sector. Rather than special subsidies to any private tourism facility, public funds could be used to build public goods that benefit the tourism sector, such as improved roads, water and sewer connections, training facilities, better managed coastal areas, and to create conditions to allow the private sector to provide better power and telecommunication services to potential tourism poles.

### F. Telecommunication

The explosion of the cellular phone industry in Nicaragua (jumping in a couple of years from around 50 thousand subscribers to 250 thousand) demonstrates what technology and appropriate policies can accomplish. This has allowed the country overcome a major gap in its development.

Internet subscribers, at only 18,000 and 100,000 users, demonstrate the challenges ahead. In this area, the most important suggestion that could be made is to monitor the policies and ensure that competition continues to thrive. As new wireless technology continues to drop in price, the number of Internet users could also balloon. The information and communication technologies are the pathway to globalization. Nicaragua and El Salvador, for example, are both courting call centers to meet the language needs of Latino migrants in the United States.

As an element in governance, a private-public council on digital education for economic competitiveness could steward the process to boost ICT technologies in the country and make sure the digital divide doesn't exacerbate the existing inequality and economic exclusion. In the Era of Knowledge, to become competitive is no longer enough. The real challenge is to stay competitive. A small and poor country in the past was left behind because it could not afford to maintain a presence in many disciplines. Nicaragua cannot afford to be left behind. Its universities and technical centers should deepen their connectivity with the digital teaching and research community.

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ICT like every technology could do harm in two dimensions: access and content. The collaboration of Nicaraguan universities with U.S. universities, or university networks, like the American Distance Education Council, in the establishment of digital learning and digital university programs in business and technical fields, could allow the university to leapfrog ahead of many universities in Latin America. Monterrey Tech in Monterrey, Mexico and the University of Chile are also pioneers in this field and constructive alliances could be engineered with them.

As an element in governance, a private-public council on digital education for economic competitiveness could steward the process. This is a field where one finds a lot of noise, and has to be careful on the approaches. But in the Era of Knowledge, to become competitive is no longer enough. The real challenge is to stay competitive. A small and poor country in the past was often forced to be left behind because it could not afford to maintain a presence in many disciplines. Nicaragua does not need to be left behind. Its universities and technical centers should deepen their connectivity with the digital teaching and research community.

But the inclusive prosperity issue remains: will this digital revolution exacerbate the difference between those with the language skills and access and those without them? Who will provide the content in the language and with the symbols that the majority of the population can understand? The digital revolution is shaping society, but it is also aggravating the effect of the knowledge gap, and knowledge will drive income distribution. The future of the private sector will clearly depend on the knowledge of its managers and labor force.

### G. Energy Sector

Energy costs endanger the economic recovery of Nicaragua. Alternatively, however, energy could become the competitive edge of the Nicaraguan economy. Private sector participation in small to medium hydroelectric projects may begin producing the necessary power to sustain the economy while minimizing its oil exports. The specific suggestion is to implement legislation required to encourage significant private sector investments in the generation, transmission and distribution of electricity. This is a key area as rural poverty is often aggravated by lack of energy.

Energy costs endanger the economic recovery of Central America in general and especially of Nicaragua. But it does not need to be so. Energy could become the competitive edge of the Nicaraguan economy. Space does not permit to expound on this theme, but private sector participation in small to medium hydroelectric projects (e.g., two megas) can begin producing the necessary power the economy will need while minimizing its oil exports (a barrel of this commodity is quoted at this time at $35, and may double within two years). One suggestion is to have the legislation required to encourage significant private sector investments in the generation, transmission and distribution of electricity.

The World Bank has provided solid guidance in the megaprojects. It also has helped develop and promote energy efficient technologies for the rural poor and isolated. Prior to this analysis, the potential of Nicaragua to participate in this successful energy program was discussed with the key officer in the World Bank, and he is willing to visit the country to discuss it. Rural poverty is often aggravated by lack of energy. This World Bank program may help address this serious constraint.

Excellent reports continue to address the agricultural and rural development in Nicaragua (Bathrik, 2003; World Bank 2003). Only a couple of concrete examples will be suggested.

Currently, there is the potential to increase the export value of beans (and income per manzana) by producing varieties the market wants. However the seed distributed by official agents belongs to a variety rejected by the market. This lack of coordination among different agencies is precisely one of the objectives set for the discussion mesas so vehemently supported by the government. Besides the lost income opportunities to small farmers this indicates that the mesas need to focus more on specifics oriented to solve problems and enhance concrete solutions.

A major infrastructure project will connect the El Rama port in the Atlantic Region to Managua. This will open up new agricultural land and opportunities to integrate economically a vast marginal region. The price of cacao is at an all time high, and this region could be a major producer of cacao. The required cacao expertise in the region resides in the USAID established FHIA, in Honduras. CATIE, in Costa Rica, has an excellent seed collection. Additional expertise could be gained from EMBRAPA, in Brazil. The suggestion here *is not to launch a cacao* *program*. But to organize a public-private sector investors-agribusiness group to explore the cacao potential of the region.

### H. Agribusiness

Currently, there exists potential to increase the export value of beans by producing varieties the market wants. However the seed distributed by official agents belongs to a variety rejected by the market. This lack of coordination among different agencies is precisely one of the objectives set for the discussion coordination mesas. In fact, problems such as this indicate that the mesas need to focus more on specifically oriented results to solve problems and enhance concrete solutions.

A major infrastructure project will connect the El Rama port in the Atlantic Region to Managua. This will open up new agricultural land and opportunities to integrate a vast marginal region. The price of cacao is at an all time high, and this region could be a major world producer and exporter of cacao. Nicaragua should organize a public-private sector investor-agribusiness group to explore the cacao potential of this specific region. The required cacao expertise to support such an analysis can be found in FHIA in Honduras, CATIE in Costa Rica, and EMBRAPA in Brazil. Given the potential to affect thousands of people living in poverty situation, this suggestion should be a priority to the GON and the donor community.

### I. Mining

No specific suggestion is made for this field. With the soaring economies of China and India, and their gluttonous demand for minerals (as well as from other major emerging global players), mining continues to be relegated to arcane handling when it should form an integral part of a potential mainstream economic activity. The discovery and extraction of important minerals in the Dominican Republic afforded the government the breathing room required to launch the transformation of what was, at the time, a nearly collapsed state. On the other hand, many developing countries exporting oil or valuable minerals have been unable to resist the massive corruption that taints those involved in these operations. Nevertheless, mining should be part of the national development agenda, and the more integrated it is, the greater the probabilities it will benefit the general population.

ANNEX A

# Aide Memoire

## ADMINISTRATIVE BARRIERS TO INVESTMENT IN NICARAGUA:

## TAKING STOCK

**December 2002**

Foreign Investment Advisory Service
a joint service of the
International Finance Corporation
and
The World Bank

i. Administrative processes might seem to be just a mundane part of everyday life to high-level policymakers. Most of them, individually, do not seem too arduous. However, if there are a lot of them, they can add up to increase costs, delays and uncertainty for investors to a significant degree. They also signal the extent to which a country's government is friendly or not to investors. Too many unnecessary and complex regulatory processes can make the difference between a country being an attractive location for foreign investment, and one that is not. A delay of a few weeks at each of several government agencies may seem of little consequence to the responsible official in each agency, and they may even profit a little from the delay, but it can cost an investor thousands of dollars in wasted time and lost revenues. This sets the wrong tone with investors, especially with small-and-medium-sized investors (SMEs) with limited resources and export-oriented firms that could locate to competitor nations with more conducive business environments.

ii. The Government of Nicaragua has recognized the importance of improving the investment climate in the country to allow the country's industries to compete effectively in the globalizing world economy. The creation of three national Commissions to support and coordinate investment promotion, competitiveness and free trade agreements, as well as the creation of the new investment promotion agency Pro-Nicaragua is testimony to the engagement of the government. That administrative processes pose a constraint to private enterprises – foreign as well as domestic – is also not a secret. In fact, a number of analyses and studies of specific areas already exist and several initiatives are already in place such as UCRESEP for the modernization of the state as well as a Ventanilla Única at MIFIC. All these point in the right direction, but despite of all these efforts, the country still suffers from excessive bureaucracy when trying to build up the country's private sector.

iii. One of the most noticeable facts in Nicaragua is the strong engagement of the entire donor community – bilateral as well as multilateral. Equally noteworthy, though, is the fundamental lack of coordination among these different entities and their various initiatives. Not surprisingly, while there has been a significant degree of activity in the area of administrative reform in the country, the overall impact has been somewhat limited, primarily because the different efforts have remained largely unconnected and were not guided by a coherent, nationwide strategy.

iv. Recognizing these shortcomings and persistence of administrative obstacles to investment, Pro-Nicaragua requested FIAS assistance in evaluating these constraints and to help them design a strategy to remove these obstacles. In collaboration with the World Bank's Procompe program, FIAS decided to start this engagement with a simple stocktaking exercise. Rather than starting with a full-scale administrative barrier study, it seemed advisable to first review all sources of information as well as ongoing initiatives to develop a clearer picture of what is known or not known about administrative constraints to investment in Nicaragua.

v. This analysis is the result of this work. It clearly shows that the knowledge on this subject in the country is already extensive. While not comprehensive, it probably suffices as a starting position to develop a coherent strategy of administrative reform with the overall objective of improving the country's investment climate for domestic and foreign investment. Just a cursory assessment of the existing information shows a number of significant shortcomings that pose serious concerns for investors.

vi. Taxation stands out as the most critical issue. The review reveals that the complex system of multiple taxes at the central as well as the municipal level make it difficult even for trained individuals to assess the actual, effective tax burden. This is further exacerbated by the lack of international accounting standards. Without clear and reliable information businesses find it difficult to move through the tax reporting process, frequently resulting in frustration and delays. Finally, the issue of massive delays in tax reimbursements adds to the aggravation. While a tax reform is currently under preparation, it does not seem to be geared primarily to making the system more user- or investor-friendly, reflected in the fact that the private sector does not seem to participate in this process in any significant fashion.

vii. Secondly, customs is a critical area of concern for investors. While significant reform activities seem underway, survey results as well as anecdotal evidence regarding import and export permits suggest that the system is still complex and cumbersome. Clearly, Nicaraguan customs cannot yet be considered a client-oriented service by the government with 24/7 operation in a paperless or virtual environment. Given the importance of exports for most private industry – most importantly FDI operations – this area deserves special attention.

viii. Thirdly, business regulations and registration procedures pose a severe bottleneck. Outdated FDI registration requirements combine with a constitutive company registration process with antiquated administrative procedures and excessive documentation demands at multiple stages to create a truly inconvenient process for investors that can take months. In addition, most investors still have to obtain industry-specific permits and approvals, many of which appear to be extremely time-consuming. Nicaragua should strive for a simple, declarative process that is sufficiently streamlined as to allow for a complete digitalization of the process, at the end making it possible for investors to apply online for company registration. But this requires substantial preparatory work first.

ix. In the area of land access, fragmented and unreliable land cadastre and title information make it extremely cumbersome to lease or acquire plots of land. While reform initiatives are underway, they would need to be strengthened to also include the main areas of industrial or productive activity. As this process will necessarily take some time, the Government should consider and evaluate alternative means such as creating more dedicated zones or industrial parks managed by the private sector. Finally, little if any information is available about the process of site development with the exception that the environmental approval process appears slow and demanding. A more detailed review seems advisable to evaluate with care whether and where this process might pose bottlenecks for investors.

x. Finally, in the area of employment, the short validity of work permits for foreigners as well as the unusually generous compensation scheme for justified layoffs are areas of concern. The first makes it more difficult for investors to attract skilled labor from abroad to enhance operational efficiency, while the second simply makes it less attractive to hire domestic labor. Both issues clearly deserve attention.

xi. Tackling all these diverse issues, cutting across a wide range of the public sector administration, certainly is not an easy undertaking. In addition, most governments trying to deal with these problems feel pressed to show immediate results. Hence, the frequent reaction by senior government is to either initiate a few reform activities geared solely towards those issues that seem politically easier and faster to correct, or to create a One-Stop Shop (Ventanilla Única) as an entity to take responsibility for all administrative processes affecting private investment. The same type of pressures are visible in Nicaragua with both alternatives being discussed or pursued at this time. In practice, however, either one of these measures consistently failed to deliver the expected results:

- A focus on “quick wins” alone typically does not remove or reform those administrative barriers that pose the most significant challenges for the private sector. Criticism tends to arise fast that the government does not have the political will or stamina to carry out serious reforms.
- Regarding One-Stop Shops, an extensive experience exists worldwide with extremely disappointing results. In fact, not a single country exists where an agency with full authority over a wide range of administrative processes for investors has been implemented successfully. Frictions among different authorities and unwillingness to cooperate (despite serious pressure from senior government) frequently convert these entities into “one more stops”, with investors having to go through one more authority to obtain all their necessary permits and approvals.

xii. This is not to say that these approaches cannot play a useful role. But this can only be the case if they are embedded in an overarching reform program, geared towards systematically removing administrative hurdles by streamlining and reforming the various processes. This analysis therefore provides suggestions and recommendations on how to initiate such a reform program in Nicaragua

xiii. The basic concept of this reform program is for one of the newly established Commissions – most likely for competitiveness or for investment promotion – to take on their agenda the issue of administrative reform. While the Commission needs to set the overall strategy, work plan, coordination with the private sector and the donor community, as well as monitoring of the progress of the different reform initiatives, it would need to have a Technical Secretariat responsible for the initiation and supervision of the reform work. Given its past experience in the area of administrative reform as well as its location under the Vice-Presidency, UCRESEP might be a possible candidate for this task, assuming that the role of the unit can be enhanced sufficiently such that it has a clear focus on business-related administrative processes. Underneath the Secretariat a series of Technical Committees – composed of a small number of representatives from the relevant authorities, the private sector and other key entities – would be established to carry out the detailed reform work along the lines of defined set of policy areas (suggested in this analysis are five Committees in the areas of tax administration, customs procedures, business registration, land and site development, as well as employment issues). This work would encompass the definition of the concrete problem issues, the evaluation of streamlined alternatives and their implementation.

xiv. Should the Government decide to adopt such a reform program, FIAS as well as the World Bank's Procompe project would stand ready to support these efforts. In addition, a number of other donor agencies might be willing to provide additional support. Concretely, FIAS could assist in the creation and organization of the reform framework, provide technical assistance in some of the areas, and assist the Technical Secretariat in developing a monitoring and reporting structure to measure the impact of this reform work.

## ANNEX B

### AGENDA FELIPE MANTEIGA

| | | |
|---|---|---|
| **LUNES** | 9:00 AM | Horacio Rose, SESEP |
| | 11:00 a.m | BANCENTRO<br>Julio Cardenas |
| | 12:00 m | IICA - Almuerzo<br>M. Rojas, J. Johnson, M. Chanlate, G. Escudero,<br>F. Manteiga, E. Laureano, A. Fonseca |
| | 2:00 p.m | Agencias Vassalli<br>Danilo Guevara y Juan Carlos Mejia |
| | 3:30 PM | |
| **MARTES** | 8:30 a.m | Empresa Puertuaria Nacional<br>Genaro Espinales |
| | 11:00 a.m | Corporacion Zona Franca<br>Gilberto Wong |
| | 12:00 m | |
| | 2:00 p.m | ProNicaragua<br>Juan Carlos Pereira |
| | 4:00 p.m | |
| **MIERCOLES** | 9:00 a.m | Banco Central - Mario Flores |
| | 10:30 a.m | TELCOR - Ernesto Zapata |
| | 12:00 m | |
| | 2:00 p.m | |
| | 4:00 p.m | |
| **JUEVES** | 8:30 a.m | IICA - James Johnson |
| | 10:30 a.m | MIFIC, Mario Arana |
| | 2:00 p.m | PROVIA - Margarita Rojas, Mauricio Zacarias |
| | 3:30 p.m | UCA |

| | |
|---|---|
| BANCENTRO - Julio Cardenas o Carlos Briceño<br>278-2777 | YA |
| BAC - Luciano Astorga<br>274-4444 | Llamaran a confirmar, 06/02 |
| BANCO CENTRAL - Mario Flores<br>265-0500 | Confirmado |
| ProNicaragua - Juan Carlos Pereira | Confirmado |
| MIFIC - Mario Arana, Ana Cecilia, etc.<br>278-8712, 222-3837 | Confirmado |
| IICA - Escudero, Chanlate, Rojas, Johnson | YA |
| VASSALLI - Danilo Guevara, Juan C. Mejia | YA |
| PROVIA - Margarita Rojas | Confirmado |
| CORP. ZONA FRANCA - Gilberto Wong<br>263-1464 | YA |
| TELCOR - Eduardo Urcuyo<br>Carmen Elizondo (Asist.) 222-7325, 222-7348 | Confirmado |
| EPN - Genaro Espinales<br>222-2059 | YA |

## CITAS EN NICARAGUA

**BANCENTRO**
Julio Cárdenas - vicepresidente
278-2777

**BANCO CENTRAL**
José Félix Solís - Gerente Estudios Económicos
José Jesús Rojas - Sub Gerente Investigación Económica
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Juan Carlos Pereira - Director Ejecutivo
270-6400

**IICA**
Gerardo Escudero - Representante
Marino Chanlatte - Director Proyecto EPAD
Miguel Iñiguez - Coordinador de la Unidad de Seguimiento y Evaluación
James Johnson - Director Agronegocios

**TELCOR**
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**MIFIC**
Mario Arana - Ministro
Ana Cecilia Tijerino - Asesora
Danilo Manzanales - Director CPC (Comision Presidencial de Competitividad)

**PROVIA**

Mauricio Zacarías - Productor Privado
Julio Castillo - Productor Privado
Dionisio Cuadra - Productor Privado/Agro Turismo
Pedro Silva - Productor Privado/Forestal